- shall account for all transactions with a Section 272 affiliate in accordance with accounting principles designated or approved by the Commission, 47 U.S.C. § 272(c)(2).

d. A company required to operate a separate affiliate under this section shall obtain and pay for a joint federal/state audit every two years conducted by an independent auditor to determine whether such company has complied with Section 272, and particularly whether the company has complied with the separate accounting requirements under Section 272(b), 47 U.S.C. § 272(d)(1).

e. A BOC and a Section 272 affiliate that is subject to the requirements of § 251(c):

- shall fulfill any requests from an unaffiliated entity for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone and exchange service to itself or its affiliates, 47 U.S.C. § 272(e)(1);

- shall not provide any facilities, services, or information concerning its provision of exchange access to the Section 272 affiliate unless such facilities are made available to other providers of interLATA services in that market at the same terms and conditions, 47 U.S.C. § 272(e)(2);

- shall charge the Section 272 affiliate or impute to itself (if using access for its provision of its own services), an amount equal to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carrier for such service, 47 U.S.C. § 272(e)(3); and

- may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such facilities or services are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated, 47 U.S.C. § 272(e)(4).

EXHIBIT DC-2

SUMMARY OF THE ACCOUNTING SAFEGUARDS ORDER

Exhibit DC-2

Additional modifications required by the Accounting Safeguards Order are summarized as follows:

- InterLATA telecommunications services, including in-region and out-of-region services and certain types of incidental services that may be provided on an integrated basis should be treated by the BOC as nonregulated activities for accounting purposes in order to "sufficiently safeguard against cross-subsidization without imposing additional accounting requirements on carriers." Accounting Safeguards Order, ¶¶ 75 and 257.

- The separate affiliate is required to, at a minimum, provide a detailed written description of the asset or service being transferred and the terms and conditions of the transaction on the Internet through the company's home page within ten days of the transaction. *Id.* at ¶ 122.

- In order for a BOC to use prevailing price for a particular product or service, it must have annual sales, as measured by quantity, of greater than 50 percent of a particular product or service to third parties to satisfy the requirement that there be a "substantial" amount of outside business. *Id.* at ¶ 135.

- In order to reduce a carrier's ability to value a transfer so that it can pass on to its affiliates any financial advantages flowing from how it chooses to characterize a transaction, a carrier must value transfers of services using the same valuation methods currently used for asset transfers. *Id.* at ¶ 146.

- To ensure that the transactions between carriers and their nonregulated affiliates take place "on an arm's length basis" and to guard against cross-subsidization of competitive services by subscribers to regulated telecommunications services, carriers are to record all affiliate transactions that are neither tariffed nor subject to prevailing prices at the higher of cost and estimated fair market value when the carrier is the buyer or transferee. *Id.* at ¶ 147.

J. Gillan

BEFORE THE CORPORATION COMMISSION OF THE STATE OF OKLAHOMA

APPLICATION OF ERNEST G. JOHNSON, DIRECTOR OF THE PUBLIC UTILITY DIVISION, OKLAHOMA CORPORATION COMMISSION TO EXPLORE THE REQUIREMENTS OF SECTION 271 OF THE TELECOMMUNICATIONS ACT OF 1996.	§ § § § § § § §	Cause No. PUD 970000064

STATEMENT OF JOSEPH GILLAN
ON BEHALF OF
AT&T COMMUNICATIONS OF THE SOUTHWEST

I. INTRODUCTION AND QUALIFICATIONS

1. My name is Joseph Gillan. My business address is P. O. Box 541038, Orlando, Florida 32854. I am an economist with a consulting practice specializing in telecommunications. My clients span a range of interests and have included state public utility commissions, consumer advocate organizations, local exchange carriers, competitive access providers, and long distance companies.

2. I am a graduate of the University of Wyoming where I received B.A. (1978) and M.A. (1979) degrees in economics. My graduate program concentrated on the economics of public utilities and regulated industries with course work emphasizing price theory and statistics.

3. In 1980, I joined the staff of the Illinois Commerce Commission where I had responsibility over the policy content of Illinois Commission filings before the U.S. District Court and the Federal Communications Commission. In addition, I was responsible for staff testimony relating to the emergence of competition in regulated markets, in particular the telecommunications industry. While at the Commission, I served on the staff subcommittee for

the NARUC Communications Committee and was appointed to the Research Advisory Council overseeing NARUC's research arm, the National Regulatory Research Institute.

4. In 1985, I left the Commission to join U.S. Switch, a venture firm organized to develop interexchange access networks in partnership with independent local telephone companies. At the end of 1986, I resigned my position of Vice President-Marketing to begin a consulting practice. I currently serve on the Advisory Council for New Mexico State University's Center for Regulation. A complete description of my qualifications, publications and testimony is attached as Exhibit JPG-1.

II. PURPOSE AND SUMMARY OF STATEMENT

5. The purpose of my statement is to address the significance of the Commission's determination whether Southwestern Bell Telephone Company - Oklahoma (SWBT) satisfies Section 271 of the Federal Telecommunications Act of 1996 (FTA). Compliance with Section 271 is a prerequisite to its being permitted to offer interLATA long distance services in Oklahoma. Although the ultimate decision concerning a Bell Operating Company's (BOC) request to provide in-region interLATA long distance services resides with the Federal Communications Commission (FCC), state commissions play an important role investigating the factual predicates underlying such a request. As this Commission investigates the factual basis of SWBT's claimed compliance, it is critical that the Commission appreciate the significant changes that will be necessary for a truly competitive local exchange service market to develop and the importance of Section 271 in achieving that end.

6. As I demonstrate below, SWBT's ability to offer interLATA services (once it obtains legal authority) will be rapid and broad. This is because for an entrant seeking to provide long distance service, the *long distance* equivalents to the "network elements,"

"interconnection" and "resale" required by Section 251 of the FTA are tested, proven and readily available. In contrast, the network elements (including operational support systems), interconnection, and resale required for an entrant to provide *local exchange* service (and mandated by Section 251 of the FTA) are *not* proven and readily available. There has not been -- and indeed there is not yet today -- local exchange competition in Oklahoma using such tools. Thus, there is no practical experience to judge whether the terms and conditions on which SWBT proposes to make these tools available will really make effective local exchange competition possible.

7. Section 271 removes the *final* barrier to SWBT offering long distance services. Before this occurs, the Commission must verify that SWBT has fully implemented each of its obligations intended to eliminate (or greatly reduce) barriers that today prevent others from offering local exchange services. The only way to be sure that SWBT has appropriate incentives to provide the tools that will really enable local exchange competition to develop is to avoid premature granting of interLATA authority to SWBT. As a fellow BOC executive said with respect to GTE:

> The big difference between us [Ameritech] and them [GTE] is they're already in long distance. What's their incentive to cooperate?[1]

8. Prematurely authorizing SWBT to offer interLATA services before each of the necessary tools for local competition is fully implemented will disrupt the fragile balance between incentive and obligation. Once authorized to provide interLATA services, this historic opportunity to fundamentally restructure the telecommunications industry will be lost.

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1 *Washington Post*, October 23, 1996, page C14 (quoting Dick Notebart, CEO Ameritech).

9. In my statement, I demonstrate the following principal points:

- The expectation that full service packages (*e.g.*, one stop shopping) will come to dominate the telecommunications industry is an observation with serious implications for competition generally. If true, this means that the fundamental foundation of any such service package, *i.e.*, local exchange service, *must* become competitive in order for competition to succeed everywhere else.

- SWBT's ability to rapidly offer long distance services does not depend upon theoretical abstractions. The tools needed by SWBT to provide competitive long distance services -- that is, "long distance" network elements, interconnection, resale and operational support -- are all very real and readily available to SWBT from multiple suppliers. In contrast, a new entrant's ability to rapidly offer local exchange services is entirely dependent upon one carrier -- SWBT -- and SWBT's representations that it *will* provide each of the tools required under Section 271 on the same terms and in the same intervals that SWBT enjoys, even though this has never been done before.

- The fundamental predicate to broad competition is access to SWBT's existing network on equal terms, so that the economies of density and scale can be shared by multiple providers and not used exclusively to promote SWBT's market dominance. That is what the FTA contemplates and that is what the FTA requires before interLATA entry is permitted.

- The FTA will be a failure if it simply results in the re-emergence of a vertically integrated Bell monopoly. It is absolutely vital that the solution to the former Bell System's dominance -- the interLATA restriction -- not be removed until its cause -- in this case SWBT's exchange monopoly -- is corrected.

- Section 271 (in lay terms) both defines the policy alternative to a line of business restriction (*i.e.*, local competition) and requires that regulators confirm that the policy works. That is, Section 271 first requires that SWBT implement (not just promise) each of the tools needed (or, at least, expected to be needed) to establish a competitive local market (*i.e.*, the Competitive Checklist); and, second, that meaningful local competition be the result.

- The Commission should not be distracted by the superficial appeal of Section 272 of the FTA's minimal competitive safeguards; there is no acceptable substitute to actual competition, non-

> discriminatory access and cost-based rates. While a separate subsidiary may prevent (or, at least facilitate the detection of) the most obvious forms of discrimination (particularly involving provisioning), economic discrimination can be prevented *only* through cost-based access to SWBT's network. Any non-cost component in SWBT's carrier-to-carrier tariffs will provide it an advantage over its rivals that no amount of "left-hand pays right-hand" transactional accounting can prevent.

10. The bottom line is that the Commission must carefully evaluate the evidence that SWBT has fully implemented the tools needed for effective local competition, and that the result is tangible, measurable, competition on a commercial scale.

III. THE COMPETITIVE IMPLICATIONS OF FULL SERVICE COMPETITION

11. As a threshold matter, it is important to recognize that the removal of the interLATA restriction on SWBT has implications for both "local" and "long distance" competition. The most likely consequence of the removal of SWBT's interLATA restriction is the reintegration of the local and long distance markets. Although this issue is frequently described as SWBT's "entering" the interLATA market, such a description is misleading. SWBT will never operate as a conventional interexchange carrier, providing long distance services to a customer that obtains local service from another provider. Rather, SWBT will operate as a full service provider, offering both local and long distance services.[2]

12. As I discuss in more detail below, the combined effect of a market-preference for "one stop" shopping and SWBT's full participation as a one-stop-provider will have a dramatic effect on the structure of the telecommunications industry. SWBT will not "enter" the long distance market so much as its interLATA authority will effectively eliminate long distance

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[2] I recognize that SWBT will use a different *legal* entity to offer interLATA service. The relevant issue, however, is whether SWBT will offer its interLATA services through an entity that is perceived as a separate provider by Oklahoma consumers. If not, then the legal distinction is immaterial. I discuss later in this statement the limited usefulness of "structural separation" as a regulatory safeguard.

service as a separate market. As consumers shift to full service providers, it must become as simple for long distance carriers to offer exchange services as it will be for SWBT to offer long distance services or competition in both markets will be jeopardized. Local entry barriers must become as low as those in long distance or competition in both markets will fail.

13. Most industry observers agree that there exists a significant consumer demand for "one-stop" shopping where customers will choose a single provider of both local and long distance service, with some packages including Internet access and mobile service as well. Although it is unknown what percentage of the market will prefer a full-service provider, there is little doubt that it will be competitively significant. Certainly, there are large, sophisticated users which today, and in the future, will choose a mix of suppliers for diversity, reliability and price. At the other end of the spectrum, there are undoubtedly consumers for whom the entire issue is more bother than benefit, and I would not expect them to change. But, between these extremes lies the majority of consumers for whom the concept of "telephone service" includes both local and long distance.[3]

14. The expected dominance of one-stop shopping involves more than the simple convenience of obtaining two services from a single source or the ability to receive a single bill. These services essentially define each other: together, they must form a complete whole or the consumer suffers a gap in service. In today's monopoly local environment, this observation has little meaning. The incumbent LEC designs the local service and long distance offerings

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[3] It is useful to remember that today's "familiar" division between long distance and local markets is just over a decade old. Prior to divestiture, an undifferentiated "phone company" provided both local and long distance service -- even those "phone companies", such as GTE, that were not a part of the Bell System. The point is that the consumer's perception of phone service as including both local and long distance was the norm far longer than the exception.

conform to its standard. Once competition extends across both product lines, however, any clear distinction will disappear.

15. There are a number of events which foreshadow the type of market success that SWBT could expect as a full service provider, including:

- Cellular long distance presubscription behavior. The Bell companies are now able to provide long distance service for their cellular subscribers. It has been reported that over 90 percent of the BOC's new cellular subscribers have also selected the BOC for long distance service.[4]

- GTE anticipates capturing 30 percent of its in-region market within 3 years of its long distance entry.[5] This would mean that GTE, which earlier *exited* the long distance industry because of a lack of success, now expects to achieve in 3 years an in-region share 50 percent larger than the share that MCI needed two decades to accomplish.

- The long distance customer base of Southern New England Telephone (SNET) (the local phone company serving Connecticut) grew by 218 percent in the past year. SNET's market share in the two years it has offered long distance service is now 25 percent. By comparison, SNET's intraLATA toll revenues showed a quarterly decline of only 3 percent despite aggressive competition from interexchange carriers.[6]

16. If consumers prefer one stop shopping -- and available evidence suggests this is the case -- then there must be competition for each element in the "one-stop package" or competition in all telecommunications markets will suffer. The single most important element of any package -- indeed, the *compulsory* element of the package -- is local phone service. Without local exchange service, many of the other services that will comprise a full service package (long distance, for instance) are not possible.

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4 Merrill Lynch, *Telecom Service Bulletin*, May 14, 1996, at 7.

5 *Id.* at 43.

6 *Telecom Services Bulletin*, August 9, 1996, at 5.

17. It is not an understatement to say that local service *must* become competitive or full service competition will never be a reality. What is more, however, is that it also follows that SWBT cannot be permitted to offer interLATA long distance services (and thus become a full service provider) until others can just as easily offer local services and compete.

18. The expected consumer preference for one-stop shopping means that barriers to offering local exchange service must fall as low as the barriers that SWBT will confront (or, in this instance, *not* confront) as it seeks to add long distance service. As I show below, SWBT's ability to offer interLATA services will be rapid and complete. It will quickly be able to offer long distance services to every customer within its territory as soon as it has obtained its legal authority. Thus, before it is able to exercise this legal authority, it must have fully implemented the FTA's requirements and local service must be subject to meaningful competition.

IV. A COMPARISON OF LOCAL AND LONG DISTANCE ENTRY BARRIERS

A. Barriers to Entry in the Long Distance Market are Low.

19. There is no question that SWBT will be able easily to offer long distance service -- after all, thousands of firms since divestiture have entered this market without any of the advantages of being an incumbent local exchange carrier. The reason that SWBT will be able to enter the long distance market so quickly, however, is that the actions needed to reduce (indeed, eliminate) long distance entry barriers began more than 15 years ago and are now fully implemented.

20. Fifteen years ago, when the divestiture agreement was announced, the nation's exchange infrastructure was not designed to support a competitive long distance industry. Switches routed long distance calls to a single network; billing systems were designed to support end-user, not carrier, billing; conventional dialing patterns were available only to the monopoly

provider; and operational systems were all internal to the local exchange carrier and its affiliated long distance entity with no capability to support the free exercise of consumer choice.

21. Divestiture, and the FCC rules which followed it, fundamentally restructured the industry to enable long distance competition. However, the tools needed for this restructuring were not available overnight. Industry restructurings take time, and the restructuring contemplated by the FTA is no exception.

22. For instance, new switch software was developed to support a multi-vendor environment. Most notable was the deployment of "equal access" software which permitted each individual customer to select a preferred interexchange carrier. This software preserved for consumers the convenience of established dialing patterns (1+ for instance) no matter which carrier provided the service.

23. Less obvious from the consumers' perspective (but no less important), new switch software also provided interexchange carriers flexibility to establish different trunk groups for different traffic categories, including operator traffic and international traffic. And new carrier-to-carrier signaling protocols addressed problems as mundane as determining when a customer answers the phone so that accurate bills for entrant-provided long distance services would be possible.

24. Fifteen years later, these changes are all fully implemented and operational (and paid for by the interexchange carrier industry). In 1995, more than 42 million customers changed their long distance carrier, many within 24 hours of making the decision.[7] Implementing a customer's decision to change long distance carriers involves systems that are fully automated and inexpensive.

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7 Peter K. Pitsch, *The Long Distance Market is Competitive*, PITSCH COMMUNICATIONS, September 3, 1996, at 2.

25. Because of this 15 years of experience, and in direct contrast to the uncertainty surrounding local competition, the prerequisites to SWBT offering long distance service are trivial:

- SWBT must be able to *market* long distance services. Of course, SWBT already markets intraLATA long distance services, and it has a preexisting relationship with each and every subscriber in its territory.

- SWBT must be able to *convert* a customer to its long distance service. Again, the Presubscribed Interexchange Carrier (PIC)-change process described above is now fully automated, software-executed, and inexpensive.

- SWBT must be able to *provision* its long distance service. For all practical purposes, SWBT already supports the long distance traffic in its region, switching each interLATA call on its way to a long distance carrier, and switching many of these calls again as they terminate within its region.

- SWBT must be able to obtain *interLATA network* elements for the long distance switching and transmission of calls that terminate beyond its region. Long distance transmission and switching is competitively available from at least four national networks.

- SWBT must be able to *bill and collect* for its long distance services. Again, SWBT already bills each of its subscribers and continues to bill on behalf of interexchange carriers.

26. Overall, SWBT already performs (or possesses the capabilities to perform) most of the functions necessary to provide interLATA service and, for those functions that it does not, it can easily out-source these functions in a competitive environment.

27. SWBT could choose from a variety of sources to provide its long distance services. The most likely option is for SWBT to obtain long distance capacity from an underlying vendor and use this capacity to provide its own retail services, much in the same way

that local entrants will use network element combinations to provide exchange services.[8]

28. Network capacity is available in the long distance industry in a variety of forms. SWBT could contract for interLATA capacity either based on minutes-of-use or dedicated capacity (with or without access service included). SWBT could use its own carrier-identification-code (CIC) to establish billing and operational relationships with other incumbent local exchange carriers, or it could provide its service under the CIC of its underlying carrier and rely on its underlying carrier to manage these relationships.

29. SWBT is free to mix and match interLATA "network elements" in any combination it chooses to create any service it desires. There are no requirements that SWBT provide some network elements before it may purchase others, nor is SWBT limited to the resale of the retail services designed by its competitors.

30. SWBT also enjoys the option to provide its own operator services, contract for unbranded operator services, or obtain branded operator services -- all without affecting its customers' dialing pattern. The options available to SWBT are extensive, limited only by the technological capabilities of the individual network(s) that it might consider.

31. Further, SWBT will be able to immediately go to each and every customer in its territory and offer long distance services with little incremental effort. The cost to move customers to its long distance services is nominal; it charges long distance competitors $5.00 to implement such a change and its true cost (*i.e.*, its economic cost) is likely less.

32. SWBT's entry barriers are insignificant because it has the equivalent of *cost-based* network elements; it has complete control of the services it offers; it enjoys the benefit of

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[8] Alternatively, SWBT could choose to construct another national intercity network. Quest has recently announced that it intends to follow this path with an expected capital budget of $2 billion. *Wall Street Journal*, December 24, 1996.

incurring only the economic cost of its local network facilities: and each of the operational systems necessary to support its entry are fully implemented and routine.

33. Merrill Lynch summarized SWBT's interLATA opportunity as follows:

> These announcement [of BOC wholesale deals] further reinforce our view that the BOCs and GTE can obtain extremely big discounts on LD capacity (as much as 85 percent off retail, net of access) from the 4 existing suppliers and thus can offer long distance service without the heavy up-front capital investment that has characterized the phone business, local and long distance, heretofore. Indeed, the existence of a buyers' market for wholesale long distance capacity -- which, in turn, derives from the high fixed, low variable cost of running a LD transport network and the fact there are 4 able suppliers -- means the BOCs can translate a few percentage points of initial LD market share into the lowest cost of goods sold in the LD industry and thus the highest potential pretax margins and/or an extra budget for sales, promotion and customer service.[9]

B. Barriers to Entry in the Local Service Market are High.

34. By contrast to entry into the long distance market, the barriers to entry into the local service market are high. As a starting point, the Commission should understand that long distance networks exhibit significantly different economic characteristics than local networks. Intercity long distance networks are high-usage facilities, requiring relatively little switching investment, with more flexibility in right-of-way selection between distant points. As a result, the nation's experience establishing long distance competition was relatively rapid (*i.e.*, *only* 20 years) and successful.

35. These attributes, however, do not apply to local networks. Local networks are constructed to specific premises for individual consumers, not general areas. Switches are located closer to customers, loop investment sits idle much of the day, and

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9 Merrill Lynch, BellSouth/AT&T Contract Reinforces the BOC/GTE Investment Case, June 20, 1996, reprinted as Appendix 5 to *Telecom Services Bulletin*, August 9, 1996.

local calling volumes far exceed those of long distance. Such characteristics make entry into this market significantly more costly than entry into the long distance market.

36. For comparison, consider:

- AT&T serves the entire nation with just over 130 switches (MCI, Sprint and WorldCom use fewer); the LECs have 23,000.[10]

- In Oklahoma alone, SWBT has over 256 switches, while AT&T has only 3 switch.[11]

- In 1995, long distance carriers serving BOC territories switched 54.6 billion interLATA calls; the BOCs switched 482.7 billion calls, nearly 9 times more.[12]

- Each long distance switch typically routes the traffic of multiple cities (sometimes states); local switches, on average, handle the routing of 6,200 customers.[13]

37. Local networks are more difficult to replicate because their ubiquity and scale give rise to substantial declining costs. Because of the local exchange carriers's economies of connectivity, density and scale, competition will not develop in local markets unless these incumbents share these economies with other service providers, an outcome which requires the complete implementation of the unbundling and interconnection requirements of the FTA including modifying operational and billing systems to make these tools real.

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10 *In the Matter of Implementation of the Local Competition Provision of the Telecommunications Act of 1996;* CC Docket No. 96-98 (rel. August 8, 1996) (First Report and Order), ¶ 411.

11 Table II, ARMIS 43.08, Page 1.2 (1995).

12 Table 2.10, STATISTICS OF COMMUNICATION, Common Carriers, 1995, all Reporting BOCs.

13 Table 2.10, STATISTICS OF COMMUNICATION, Common Carriers, 1995, all Reporting LECs.

V. ELIMINATING LOCAL BARRIERS

38. The low barriers to entry into the long distance market for SWBT, combined with the ease with which SWBT can market its one-stop service to each and every customer in its territory, provide a significant interLATA opportunity. SWBT's interLATA opportunity is important to the Commission's evaluation of Section 271 compliance in two ways.

39. *First,* SWBT's interLATA opportunity is immediate and ubiquitous. As a result, the Commission should evaluate SWBT's Section 271 compliance with an eye to assure that the entry tools required under this Section provide a similarly rapid opportunity for entrants to offer local services broadly in the market.

40. *Second,* the speed and ease within which SWBT can provide long distance services means that the Commission must be absolutely convinced that the Checklist is operational and that local exchange markets are competitive *before* SWBT is allowed to enter.[14] Once SWBT *has entered* the long distance market, it will then face little incentive (none really) to take whatever other steps are necessary for competition to proceed.[15]

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[14] SWBT will no doubt claim that any sequential review will provide its competitors a "head start", but any such "advantage" will be as much an illusion as the "head start" enjoyed by the outside runner of a race. The runner in the outside lane requires a "head start" because it has further to run; similarly, entrants to the local market -- where each and every aspect of local competition is new and untested -- require working experience before the Commission can judge whether these tools are sufficient.

[15] In this regard, GTE is the "poster child"of premature entry. As noted earlier, even Ameritech recognizes that GTE has no incentive to open its market to local competition because it is already permitted to offer interLATA service. With its pockets full of quid, GTE has no incentive to live up to the FTA's quo and make the changes necessary for local competition to succeed. GTE has appealed virtually every arbitration *award* (not even waiting for the procedurally necessary step of first signing an actual *contract* before appealing). Remarkably, GTE's most recent suits request a trial by jury on each and every contested issue.

41. Verifying that the tools required by the FTA have been implemented and that rapid, ubiquitous entry is now possible is the issue pending before each state's commission. Under the FTA, the fundamental role of a state commission is as a *fact-consultant* to the FCC, determining through a practical and quantitative review of the conditions in its state that broad scale, commercial level, local competition is underway.

42. Conducting an empirical review is a critically important step in this process because, for all practical purposes, Congress adopted a national blueprint for local competition based on the limited experience of a few states, none of which had even fully implemented their own policies. The result is a law with excellent intentions, but without the benefit of a working model. Because Congress could not predict with certainty the success of its pro-competitive policies, it conditioned the BOC's interLATA entry on a demonstration that the BOC had fully complied with its obligations (the Section 271 Checklist) and a demonstration that competition is the result.

43. The dramatically higher barriers to entry to the exchange market (particularly relative to long distance) must be *successfully* eliminated in order for exchange competition to proceed. Local competition depends not upon SWBT's paper compliance with abstract concepts (or, even more speculatively, *promises* of future compliance), but rather upon whether the tools entrants actually needed are available in ways that support entry on a commercial scale. In particular, the Commission must assure that the terms and conditions under which SWBT will make its network available to other carriers for the entrant's use in offering exchange services are fully operational in a manner which enables local entrants to offer services as quickly and broadly as SWBT will be able to provide long distance services.

44. Entry using unbundled network elements is the option that most closely parallels SWBT's interLATA opportunity and is most likely to yield the greatest consumer benefit. This conclusion is based on the following characteristics of entry using network elements:

- The pricing of network elements is intended to be based on cost and be non-discriminatory. As a result, both the entrant and the incumbent should have the same cost structure for the underlying network they share.

- Network elements pre-position the entrant for either network construction of its own or, at the least, the replacement of incumbent local exchange carrier-provided unbundled network elements with components obtained from third-parties.

- Network elements establish the entrant as a complete provider of local and exchange access services, an economic predicate to full service competition. Partial entry strategies -- such as service-resale -- will not drive retail prices (particularly toll prices) to cost, since the incumbent LEC retains an access monopoly to the service-reseller's customers.

- Network elements enable the entrant to craft its own unique local services, varying calling boundaries and feature mixes to meet unique customer needs, thereby unleashing the creative energies of the competitive process.

45. SWBT may claim that service-resale is sufficient to permit competition. In one sense this is true: If a carrier has no interest in designing unique services, has no reason to offer both local exchange and exchange access service, has no desire to compete aggressively with SWBT's prices, and has no intention to replace individual network components with the facilities of other carriers (or its own) as they become available, then service-resale is the ideal solution. While service-resale will provide carriers a *simple* entry option (and, for that reason, the Commission can expect that

carriers will use this approach, particularly at first), robust local competition depends upon the more challenging opportunities made possible by network element combinations.

46. For network elements to become a useful vehicle to offer services broadly in the market, however, network elements must be as easy to use as access service is today *and* it must be as easy for customers to move between local providers as it is to change long distance carriers.

47. Achieving these goals requires that local entrants have, as one of their choices, the ability to order network element *combinations*, particularly combinations which include unbundled local switching.[16] Network element combinations should permit rapid and broad entry, and are necessary to assure that customers can be moved to a new local carrier in the same interval that SWBT will be able to transfer customers to its long distance services.[17] These conditions must be satisfied prior to SWBT obtaining interLATA authority.

48. There are over 23,000 local switches in the local exchange networks of the incumbent local exchange carriers today. No competitor can replicate, any time soon, this vast switching matrix on which virtually all customer loops now terminate. Importantly, the economic cost of local switching is closely aligned with that of the loops that it connects. To the extent that loop plant is a natural monopoly, a similar (although not identical) conclusion must apply to the local switches that connect them. The switch

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[16] Certainly, other elements of the competitive checklist are also important and, of course, SWBT's compliance is not voluntary or optional. Nevertheless, the Commission should devote particular attention to verifying that SWBT has fully complied with the FTA and FCC Rules regarding the unbundling of local switching and the non-discriminatory availability of unbundled network element combinations.

[17] CFR § 51.319(c)(2)(ii) requires that SWBT transfer a customer to a competing local provider within the same interval as it transfers a customer's long distance service such a transfer is accomplished via software. Unbundled local switching makes this result possible.

at which these loops already terminate will enjoy a cost advantage over a similar switch located some distance away. Even where competitive switches are installed, however, the fact remains that the cost to reconfigure loops, particularly to connect to a geographically distant or different switch, will likely limit the utility of this form of entry to larger customers. The only way that entry will occur on a broad scale, and on an economic basis comparable to SWBT, is if multiple carriers can use the existing switches (and loop/switch combinations) to provide service.

49. With an ability to obtain the full combination of network elements, competition will not be limited to those areas, and those few customers, that will first attract alternative switches and/or local distribution facilities. Any number of entrants will be able to approach all local calling areas with new services and competitive choices because each will be able to use however much (or little) of the exchange network they need to offer their services.

50. In addition to this short-run benefit, network element combinations are also an essential protection from the industry becoming highly concentrated. Without the option of network-element combinations, only carriers with the resources to construct local exchange networks (assuming that this is not the null set) will be able to compete. The long-term competitive diversity of the telecommunications industry depends upon the full availability of unbundled network elements and the unrestricted ability to combine these elements to provide service.

51. Creating the systems to provision network elements on a scale comparable to the PIC-change process will take time to develop, test and implement. Until the Commission can safely conclude that such systems support entry on a commercial scale, these fundamental prerequisites to SWBT's interLATA authority will not be satisfied.

However eager SWBT is to achieve its interLATA goal -- and no matter how strenuously that SWBT *promises* that its systems *will* work -- only the rigor of actual market experience will determine the accuracy of these claims. SWBT will have the advantage of using systems refined through the past *decade* to enter and provide long distance services; local entrants must have operational experience before the Commission can conclude that the systems required by the FTA are at all comparable.

52. Even after the requirements of Sections 251 and 271 are fully satisfied, however, the FTA recognizes that SWBT will retain an incentive to discriminate in favor of its affiliated long distance services. As such, the FTA imposes in Section 272 minimal protections intended to lessen (but which do not eliminate) SWBT's ability to exploit this incentive by favoring its own competitive services.

53. The requirements of Section 272, and the FCC rules which implement them, however, do not lessen the Commission's need to fully assure that SWBT has complied with the checklist. These rules are no substitute for the competition expected by Section 271's full compliance. For instance, neither "imputation" requirements, nor transactional rules are a substitute for cost-based rates. The true economic consequences of SWBT's affiliate structure is relevant only when SBC Corporation reports to its shareholders. The performance of its subsidiary operations individually are irrelevant -- where two subsidiaries are providing service, all that matters is the *net* effect, not isolated performance. When you own the pants, it does not matter in which pocket you keep your money.

VI. CONCLUSION

54. The FTA holds the promise of a fully competitive telecommunications industry, but achieving this vision requires the full implementation of SWBT's obligations. A competitive *one stop* market depends upon a competitive local market. Barriers to long distance entry -- including, importantly, operational barriers -- have all fallen as a result of the nation's decades-long commitment to competition. Local barriers must fall to the same level for the next stage of the industry's evolution to succeed. The Commission must not prematurely verify that SWBT has satisfied the FTA until each of its obligations intended to eliminate local entry barriers have been fully implemented and competition is the result.

VERIFICATION

STATE OF TEXAS)
)
COUNTY OF Dallas)

I, JOE GILLAN, of lawful age, being first duly sworn, now state: that I am authorized to provide the foregoing statement on behalf of AT&T; that I have read the foregoing statement; and the information contained in the foregoing statement is true and correct to the best of my knowledge and belief.

JOE GILLAN

SUBSCRIBED AND SWORN TO BEFORE ME this 6th day of March, 1997.

Debbie Crawford
Notary Public

My Commission Expires:

DEBBIE CRAWFORD
COMMISSION EXPIRES
JANUARY 17, 1998

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